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Before the
Federal Communications Commission
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	CC Docket No. 99-249
Low-Volume Long-Distance Users	)	
	)	

ORIGINAL

Comments of AT&T Corp.

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COMMENTS OF AT&T CORP.

Pursuant to the Commission's Notice of Inquiry in the above-captioned proceeding,[1] AT&T hereby submits its comments concerning the effect that certain flat-rated charges and minimum usage requirements imposed by interexchange carriers ("IXCs") may have on customers that are low-volume users of interLATA services.

INTRODUCTION AND SUMMARY

The Notice of Inquiry ("NOI") seeks comment on the potential effects on low-volume users of interLATA services of certain flat-rated charges and minimum usage requirements imposed by IXCs. The NOI focuses on three such items: (1) monthly minimum usage requirements ("MURs"); (2) monthly flat charges designed to recover IXCs' universal service contributions ("USF charges"); and (3) monthly fees imposed by IXCs in order to recover the Primary Interexchange Carrier Charges ("PICCs") that LECs impose on IXCs for customers presubscribed to their networks ("PICC pass-through charges").[2] In particular, the Commission asks whether, in light of all circumstances in the

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[1] Notice of Inquiry, *Low-Volume Long-Distance Users*, CC Docket No. 99-249, FCC 99-168 (rel. July 20, 1999).

[2] The magnitude and terms of these usage requirements and flat charges naturally vary by IXC. AT&T applies a monthly $3.00 usage requirement to residential customers not enrolled in non-AT&T Lifeline Program or in a calling plan that already includes a monthly fee, or who are not otherwise exempt; a monthly $0.99 USF charge designed to recover AT&T's universal service (continued...)

long distance market, these usage requirements and flat rated charges raise a public policy concern with regard to low-volume users, and, if so, what an appropriate approach to these concerns might be, including market-based solutions as well as re-regulation.

The minimum usage requirement and flat-rated charges raise no legitimate public policy concern. The Commission's orders have long and correctly recognized that the interexchange market is vigorously competitive, and is characterized by an "intense rivalry" between the competing interexchange service providers and by high demand elasticity. *See infra*. For this reason, all IXCs have powerful incentives to assure that their prices are competitive, and are designed to recover costs in the most efficient manner. If any interexchange carrier attempts to impose charges that are not cost-justified, or that are structured in ways that do not optimize customer preferences, the carrier will be disciplined by the normal operation of market forces. Given the highly competitive nature of the interexchange market, regulatory intervention by the Commission could have only one effect: preventing the marketplace from maximizing customer preferences by artificially limiting the availability to customers of diverse pricing alternatives.

Although AT&T will address these and other issues raised in the NOI in full below, three points warrant special emphasis at the outset. *First*, although AT&T is under no legal obligation to do so, AT&T waives each of the items that are the focus of the Notice of Inquiry -- the USF charge, the PICC pass-through charge, *and* the Minimum Usage Requirement -- for consumers that inform AT&T that they are enrolled in or eligible for a telephone support program such as Lifeline assistance, and AT&T informed all of its Basic Schedule customers of the availability of this

[2] (...continued)
obligations associated with its consumer services; and a monthly PICC pass-through charge of $1.51 per residential account.

waiver in direct mailings that were sent long before imposition of the MUR. AT&T's waiver of these items for Lifeline customers thus assures that these fees should have no impact on customers who cannot afford them. *See infra* pp. 21-22.

Second, as demonstrated below, there is virtually no correlation between income and low-volume long distance usage. To the contrary, AT&T's data shows that across all income levels there is only a very slight difference in the average household incomes of high-volume users as compared with the low-volume users who would be affected by the $3.00 minimum usage requirement. In particular, the mean household income of all AT&T customers in January, 1999 was $44,738, while the mean household income of low-volume users who would have incurred the minimum charge was $43,160 -- a difference of just 3.5%. This minimal difference extends through all income quartiles. Thus, the mean household income of consumers in the 25th percentile of income was $31,176, as compared with an income of $30,263 for consumers subject to the minimum usage requirement -- a difference of 2.9%. Although the income differences between high and low-volume users may be "*statistically* significant" (*i.e.*, the results are sufficiently precise that they cannot be attributed merely to randomness in the sample), by any measure the difference is qualitatively negligible. Because high-volume and low-volume households have nearly identical incomes, AT&T's minimum usage requirement does not have a material impact on low-income users as a group. *See infra* pp. 22-23.

Indeed, as these data demonstrate, the income characteristics of low- and high-volume consumers is very heterogenous. Many high-income households have low long-distance usage, and many low-income households are high-volume long-distance users. Accordingly, any Commission policy that sought to direct subsidies to low-volume users of interLATA services would inevitably cause individuals with low incomes, but high long-distance usage, to subsidize high income users with second homes or second lines, or who simply do not make many long distance calls for other reasons. Regulation of the minimum usage requirements or flat-rated charges imposed by IXCs would be an ineffectual and counterproductive method of assisting low-income consumers. *See infra* p. 23.

AT&T's data also reveals a significant churn level even among low-volume users. In particular, AT&T's data reveal that in 1998 customers with average monthly bills below $10 switched long-distance service providers more often than customers with bills between $10 and $25. There is thus no basis for concluding that low-volume users require special regulatory protections, or that competitive forces in the long-distance market somehow don't extend to or benefit low-volume users.

Third, the ordinary operation of market forces provides customers that are dissatisfied with AT&T's minimum usage requirement and flat charges with numerous alternatives. For example, although AT&T and MCI currently impose minimum usage requirements, low-volume customers that want to avoid such requests can presubscribe to any of the numerous other carriers (such as Sprint) that offer calling plans that do not have minimum usage requirements or monthly fees. Such customers may also choose not to presubscribe to any IXC and instead to use the services of "dial-around," prepaid card, or calling card providers. Similarly, although AT&T believes that a flat-rated USF charge best satisfies residential customer preferences, low-volume consumers who prefer percentage based fees may presubscribe to any one of the numerous IXCs (including MCI WorldCom and Sprint), that do not recover their USF costs in that manner. Finally, while all three major IXCs have chosen (for good reason) to recover their PIC charges through a blended rate that is designed to recover a weighted average of the primary and secondary line PICC charges, low-volume single-line customers that object to the financial impact of this blended PICC recovery can choose to presubscribe to an IXC that passes through the PICC in a different manner, or can opt not to presubscribe to any IXC and simply pay the primary line PICC directly to their LEC.

Although the Commission's desire to understand the effects of competition on all users of interexchange service is certainly unobjectionable, any suggestion that regulatory intervention into the pricing of carriers in the competitive interexchange market is warranted is fundamentally misguided, and would represent an arbitrary departure from longstanding Commission precedent. As discussed more fully below, the Commission has expressly "reject[ed] the unsupported suggestion that current levels of competition are inadequate to constrain AT&T's prices,"[3] and found that "market forces will generally ensure that the rates, practices, and classifications of nondominant interexchange carriers for interstate, domestic, interexchange services are just and reasonable."[4] There is no basis for the Commission to depart from these precedents here.

To the contrary, the NOI does not point to a single market defect -- let alone a market failure -- that would justify a departure from the Commission's longstanding policy of non-regulation, and no such basis exists. The market for interexchange service, including service to low-volume users, is not characterized by any externalities: low-volume users will bear the entire cost of any calling plan they choose, and thus have every incentive to choose one that they find most attractive and least costly. In the absence of regulation that artificially prevents them from recovering their full costs, interexchange carriers, in turn, have every incentive to compete for the business of all users,

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[3] Second Report and Order, ¶ 22, *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd. 20730, 20743 (1996) ("*Mandatory De-Tariffing Order*").

[4] *Id.*, at ¶ 21.

including low-volume ones. But the same competitive forces that ensure lower prices likewise requires IXCs to eliminate historical subsidies that formerly may have benefited some users.

Nor is there any failure of information that might warrant regulatory intervention. AT&T, for example, has expended great efforts to educate consumers about each of the items as to which the Commission seeks inquiry. Well in advance of imposing its minimum usage requirement, or the flat-rated USF and PICC pass-through charges, AT&T contacted customers through bill messages, and its Internet website, and fielded numerous inquiries placed to AT&T's toll-free customer service number. At great expense, AT&T also contacted all customers potentially affected by the Minimum Usage Requirement through direct mailings. Those communications informed customers of all of the relevant terms of AT&T's minimum usage requirement and flat-rated charges, including the precise amount customers would be charged, what the items were designed to recover, the availability of waivers for Lifeline-eligible subscribers, and how those bill items would be assessed (*e.g.*, that the USF and PICC pass-through charges would be assessed on a flat monthly basis). AT&T's competitors, in turn, have widely advertised the availability of their competing offers.

In short, there is no legitimate basis for the Commission to depart from its long-standing precedents that regulation of the price or other terms imposed by IXCs is both unnecessary and affirmatively harmful. Indeed, as the Court of Appeals for the Fifth Circuit recently held, it would be unlawful for the Commission to require carriers to recover their USF charges implicitly, rather than explicitly. *Texas Off. of Pub. Util. Counsel et al.* v. *FCC*, 183 F.3d 393, 1999 U.S. App. LEXIS 17941, *63 (5th Cir. 1999).

For each of these reasons as well as those discussed below, there is no justification for the Commission to regulate the manner in which participants in the highly competitive interexchange market recover their costs from customers. As demonstrated at length in the attached declaration of Gregory Rosston, a former deputy chief economist at the Commission, "[b]ecause the long-distance market is highly competitive and competitive markets protect consumers, the Commission should refrain from imposing additional regulations on long distance carriers." Indeed, "[a]ny attempt by the Commission to regulatorily mandate the structure of pricing in the long-distance market will harm consumers by preventing carriers" from pricing their services in a rational manner "and tailoring their pricing plans to satisfy consumer preferences." Declaration of Gregory L. Rosston, ¶ 1 ("Rosston Decl.") (attached hereto as Exhibit A).

I. THERE IS NO JUSTIFICATION FOR THE COMMISSION TO REGULATE THE PRICES CHARGED BY PARTICIPANTS IN THE VIGOROUSLY COMPETITIVE INTEREXCHANGE MARKET.

At least since its *Competitive Carrier* First Report and Order in 1980,[5] the Commission has recognized that regulation of the rates charged by carriers that lack market power in the relevant market is both unnecessary and affirmatively harmful. As the Commission explained in adopting streamlined tariff filing provisions for non-dominant carriers:

> firms lacking market power simply cannot rationally price their services in ways which, or impose terms and conditions which, would contravene Sections 201(b) and 202(a) of the Act. . . . [A] non-dominant competitive firm, for example, will be incapable of violating the just and reasonable standard of 201(b). If it charges unreasonably high rates or imposes unreasonable terms or conditions in conjunction with the offering, it would lose its market share as its customers sought out competitors whose prices and terms are more reasonable.

Competitive Carrier First Report and Order, ¶ 88. Indeed, in its 1980 Order the Commission concluded not only that "marketplace forces should be sufficient to insure that the rates of

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[5] First Report and Order, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, 85 F.C.C.2d 1 (1980) ("*Competitive Carrier First Report and Order*").

competitive non-dominant carriers are reasonable," *Id.* ¶ 33 n.36, but also that imposition of a "system of regulation of [the] business conduct" of such firms would "inflict[] on society" a "significant cost[]" in the form of "the loss of dynamism which can result from regulation." *Id.* ¶ 11. *See also* Rosston Decl., ¶ 9.

As the Commission subsequently found, no interexchange carrier today, including AT&T, possesses any market power in the interexchange market for both business and residential service. Indeed, in reclassifying AT&T as non-dominant, thereby freeing it from price cap and other forms of direct rate regulation and creating the legal presumption that all AT&T rates are lawful, the Commission expressly found, on the basis of extensive record evidence, that in "the interstate, domestic, interexchange market, supply is sufficiently elastic to constrain AT&T's unilateral pricing decisions" in that "'AT&T's competitors have enough readily available excess capacity to . . . take away enough business from AT&T to make unilateral price increases by AT&T unprofitable." Order, *Motion of AT&T Corp. To Be Reclassified As a Non-Dominant* Carrier, 11 FCC Rcd. 3271, ¶ 58 (1995) ("*AT&T Reclassification Order*") (citation omitted). The Commission further found that, like many customers, "residential customers are highly demand-elastic and will switch to or from AT&T in order to obtain price reductions and desired features." *AT&T Reclassification Order*, ¶ 63 (finding a "high churn rate among residential consumers"). *See also id.* at ¶ 65-66, 88.

In the years since the *AT&T Reclassification Order*, the Commission has repeatedly reaffirmed its conclusion that the interexchange market is vigorously competitive. For example, in justifying its prohibition on the filing of tariffs by nondominant interexchange carriers, the Commission expressly "reject[ed] the unsupported suggestion that current levels of competition are inadequate to constrain AT&T's prices." Second Report and Order, *Policy and Rules Concerning* *the Interstate, Interexchange Marketplace*, 11 FCC Rcd. 20730, ¶ 22 (1996) ("*Mandatory De-Tariffing Order*"). To the contrary, the Commission's conclusion that forbearance from enforcing the Act's tariff filing requirements would not harm the public interest was expressly premised on its finding -- which was required by the statutory forbearance standard on which the order rested -- that "market forces will generally ensure that the rates, practices, and classifications of nondominant interexchange carriers for interstate, domestic, interexchange services are just and reasonable." *Id.* ¶ 21; *see* 47 U.S.C. § 10. As the Commission explained, "the high churn rate among consumers of interstate, domestic, interexchange services indicates that consumers find the services provided by interexchange carriers to be close substitutes, and that consumers are likely to switch carriers in order to obtain lower prices or more favorable terms and conditions." Mandatory De-Tariffing Order, ¶ 21.

The Commission has both reiterated and relied on these findings in numerous regulatory contexts. *See, e.g.,* Second Report and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, 12 FCC Rcd. 15756, ¶ 97 (1997) (concluding that the "excess capacity" of "competitors" in the interexchange market, in conjunction with the fact that "customers" are "sensitive to changes in price" and "would be willing to shift their traffic to an interexchange carrier's rival if the carrier raises its prices" justified classification of even BOC § 272 affiliates as nondominant in the provision of in-region interexchange service); Memorandum Opinion and Order, *Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, 13 FCC Rcd. 18025, ¶¶ 23, 40-41 (1998) (relying on existence of vigorous competition, including "intense rivalry among AT&T, MCI and Sprint," in support of conclusion that merger of second and fourth largest participants in the interexchange market would not have anticompetitive consequences in the interexchange market); Memorandum Opinion and Order, *In re Applications of Teleport Communications Group, Inc., Transferor and AT&T Corp., Transferee*, 13 FCC Rcd. 15236, ¶ 40 (1998) (pointing to extensive competition in the long distance industry in approving merger of AT&T and TCG). In each of these orders, the Commission concluded that the existence of "intense rivalry" within the interexchange market rendered proposed regulatory intervention by the Commission both inappropriate and unnecessary.

The Commission's sound decision to rely on competition to discipline pricing in the interexchange market has yielded numerous benefits to both residential and business customers as a group and the economy as a whole, and has further confirmed that there is no justification for the Commission to regulate that market. As of the end of the second half of 1998, over 600 carriers provided interexchange services. At least 20 of these carriers had annual revenues exceeding $100 million, and eight had annual revenues exceeding $1 billion. Between January 1984 and the end of 1998 AT&T's market share had declined from over 83% to 51.5%. During that time, the Bureau of Labor Statistics' "Interstate Toll Service" Price index has decreased from 101.3 to 74.7, *not* accounting for inflation, and long distance access minutes have risen from 37.5 billion in 1984 to over 520.1 billion in 1998. *Long Distance Market Shares, Fourth Quarter 1998, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission* (March 1999). Rosston Decl. ¶¶ 46-51. The increased prominence of "dial-around" services in recent years has only served to increase the options available to residential consumers: such customers not only have a choice among hundreds of carriers to whom they may presubscribe, but they have the ready ability, and are strongly encouraged in numerous advertisements, to bypass their presubscribed carrier altogether.

AT&T estimates that "dial-around" service constitutes an approximately $2 billion a year industry which spends hundreds of millions of dollars a year in advertising, much of it on network television.

Indeed, in the relatively short period of time that has elapsed since the Commission issued its Notice of Inquiry, the major interexchange carriers have each introduced further dramatic and heavily publicized reductions in per minute state-to-state long distance rates. Specifically, AT&T has introduced a plan that provides such service for 7 cents a minute, 24 hours a day, seven days a week, and MCI WorldCom and Sprint have introduced plans with 5 cents a minute rates during certain off-peak periods and significantly higher rates during other times. As Chairman Kennard has aptly put it, these rate reductions are an example of "competition at its best."[6] The evidence thus far shows that consumers are taking great advantage of these new offers: the *Wall Street Journal* reports that customer interest in these plans has exceeded expectations, overwhelming customer call centers. Rebecca Blumenstein, *Phone War Prompts a Record Number of Calls*, Wall Street Journal, Sept. 7, 1999, at B6, available in 1999 WL-WSJ 24912583.

Remarkably, in the face of the Commission's longstanding conclusion and other extensive evidence that the interexchange market for both business and residential service is characterized by intense rivalry among carriers and high demand elasticity, and that regulation of the rates charged by interexchange carriers is thus unwarranted, the NOI does not point to a single market defect -- let alone a market failure -- that would justify a departure from the Commission's longstanding policy of non-regulation, and no such basis exists. The market for residential interexchange service, including service to low-volume users, is not characterized by any externalities:

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[6] "Kennard Sees Long Distance Market as 'Competition At its Best,'" Communication Daily's Washington Telecom Newswire (August 31, 1999).

low-volume residential users will bear the entire cost of any calling plan they choose, and thus have every incentive to choose one that they find most attractive and least costly. In the absence of regulation that artificially prevents them from recovering their full costs, interexchange carriers, in turn, have every incentive to compete for the business of all users, including low-volume ones. But the same competitive forces that ensure lower prices likewise requires IXCs to eliminate subsidies that formerly may have benefited some users.

Nor is their any failure of information that might warrant regulatory intervention. AT&T, for example, has expended great efforts to educate consumers about each of the flat charges as to which the Commission seeks inquiry. Well in advance of imposing its minimum usage requirement, or the flat-rated USF and PICC pass-through charges, AT&T contacted customers through billing messages, and its Internet website, and fielded numerous inquiries placed to AT&T's toll-free customer service number. At great expense, AT&T also contacted all of the millions of Basic Schedule customers potentially affected by the Minimum Usage Requirement through direct mailings. Those communications informed customers of all of the relevant terms of AT&T's minimum usage requirement and flat-rated charges, including the precise amount customers would be charged, what the items were designed to recover, the availability of waivers for Lifeline-eligible subscribers, and how those bill items would be assessed (*e.g.*, that the USF and PICC pass-through charges would be assessed on a flat monthly basis). A sample of those letters and billing inserts, as well as print-outs of pages available on AT&T's website, are attached hereto as Exhibits B, C, D, E and F. AT&T's competitors, in turn, have widely advertised the availability of their competing offers. For example, dial around carriers place numerous mass media advertisements on a daily basis that tout the absence of any plan fees or other flat charges incurred by users of the service.

In short, there is every reason to expect, and no reason to doubt, that market forces alone will continue to discipline interexchange carriers such as AT&T to charge prices that best match consumer preferences, both in terms of the magnitude and the structure of the rates. Customers have both the incentive and the information needed to select a plan that best satisfies their needs. If an interexchange carrier attempts to impose above-cost charges, or structures such charges in unreasonable ways, customers will discipline that carrier by selecting an alternative provider. Thus, for example, low-volume customers that would be subject to AT&T's $3.00 MUR and that do not value AT&T's reputation for quality and other aspects of its service sufficiently to be willing to incur that obligation have ample alternative suppliers to whom they can presubscribe that do not impose any minimum monthly usage or fee.[7] Customers that prefer the certainty of flat-rated charges over the possibility that they might save a small amount of money in some months will prefer AT&T's method of recovering its USF contributions; customers that do not, can select any of the other carriers that have chosen, in the exercise of their business judgment, to recover such contributions on a percentage basis.[8] Finally, single-line residential customers who object to AT&T's use of a

[7] For example, Sprint offers customers a Standard Weekend Plan with no fee or minimum usage, but with rates of 30 cents a minute Monday through Friday (all day), and 10 cents a minute on weekends. These per minute rates are higher for weekday calling than AT&T's Basic Schedule rates of 26 cents a minute peak and 16 cents a minute weekday off-peak (7 PM to 7 AM), let alone when compared to the AT&T One Rate® Plan of 15 cents a minute (and these rates are only slightly lower for weekend calling than AT&T's basic weekend rates of 11 cents a minute). Clearly, low-volume customers who do not restrict their calling to weekends or whose usage varies from month to month might prefer AT&T's lower per minute rates with a usage minimum than a competitor's offer that did not include a usage minimum but which had higher per-minute fees.

[8] For example, MCI WorldCom, Sprint and numerous other IXCs have chosen to recover their USF contributions through percentage-based charges. However, many customers apparently prefer for budgeting or other purposes to know in advance what their monthly USF charge will be, particularly if the customer's calling volume varies from month to month. Indeed, AT&T's research (continued...)

blended PICC pass-through rate can choose to presubscribe to another IXC that does not pass through its PICC assessments in this way, or can choose not to presubscribe to any IXC, in which case the customer will be charged the primary PICC rate by the LEC. Rosston Decl. ¶¶ 39-40.

As explained in the attached declaration, regulation of carriers in a competitive market is thus not only unnecessary, it is harmful:

> Unnecessary regulation imposes direct and indirect costs. The direct costs caused by regulations include the costs of participating in the regulatory process and the costs attributable to the economic inefficiency caused by regulations that prevent competitiors from pricing services in an optimally efficient, market-dictated manner. If firms are prevented from charging economically efficient, optimal prices to consumers, consumer welfare will decrease. In addition, the regulatory process exposes pricing plans to competitive review; whereas challenge in the regulatory forum is based on criteria established by regulators, which are seldom consistent with competitive responses in the marketplace.
>
> In addition to direct costs, regulation of competitive markets can impose indirect costs by detrimentally affecting innovation and investment. For example, a firm may decrease investment spending if the firm is not allowed the flexibility to fully take advantage of the benefits the firm expects to obtain from the investment. Reducing investment and innovation in the short-term has long-term implications for consumer welfare. For instance, if firms fail to adequately invest in the development of new products and services in the short-term because of concern that regulators will control how the firm can price the products and services, the public will not reap the benefit of a market characterized by a broad range of products and services.

Rosston Decl. ¶¶ 42-43.

Indeed, while regulation of the prices charged by competitors in the interexchange market would have been completely unjustified even prior to February, 1996 -- as the Commission itself repeatedly found -- a decision to impose prohibitions or restrictions on the imposition of flat fees or minimum usage requirements by nondominant IXCs would be particularly perverse now, following

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[8] (...continued)
shows that its residential customers -- including low-volume users, low-income users, and older users -- prefer flat-rated charges to percentage levies. *See infra* p. 31.

adoption of the Telecommunications Act of 1996 ("1996 Act"). As the Commission has repeatedly observed, a fundamental purpose of the 1996 Act was to adopt a "'pro-competitive, *de-regulatory* national policy framework.'" *See, e.g., Mandatory De-Tariffing Order*, 11 FCC Rcd. 20730, ¶¶ 1, 130 (quoting Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 113 (1996). As reflected in the forbearance authority extended to the Commission in section 10, Congress' intent in passing the 1996 Act was that, where a sufficient level of competition existed in a particular market to make such forbearance possible, the Commission should act to remove regulatory burdens from market participants. Congress adopted this policy in recognition of the fact that competitive market forces provide consumers with the optimal range of service options, the lowest prices and the most rapid innovation. As Professor Rosston explains, "[i]ntrusive regulation that stunts the ability of firms to creatively provide attractive services to their current and potential customers blunts the competitive process. In doing so, regulation not only harms the firms involved, but more importantly can harm the consumers it is intended to benefit." Rosston Decl., ¶ 44. Thus, other than to police outright misrepresentations and fraud, the Commission's role should not be to protect consumers of services that are fully competitive from the choices they have made in the marketplace.[9]

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[9] The Commission has relied on this understanding of Congressional intent in a series of deregulatory actions taken since passage of the 1996 Act. For example, the Commission has invoked the deregulatory purposes of the 1996 Act in removing the tariff-filing obligations of the Act for nondominant carriers, (*Mandatory Detariffing Order*, ¶ *13)* in adopting a market-based approach to access charge reform, (First Report and Order, *Access Charge Reform*, 12 FCC Rcd. 15982 (1997)) and has recently gone so far as to eliminate or reduce drastically the section 214 entry and exit regulations even for *dominant* carriers. *See* Report and Order and Second Memorandum Opinion and Order, *Implementation of Section 402(B)(2)(A) of the Telecommunications Act of 1996; Petition for Forbearance of the Independent Telephone and Telecommunications Alliance*, CC Docket No. 97-11, AAD File No. 98-43, 1999 WL 439421 (FCC rel. June 30, 1999). To say the least, an attempt (continued...)

Because there is no basis for the Commission to depart from its prior determinations that marketplace forces can be relied upon to ensure that charges for long distance services are just and reasonable, any attempt by the Commission to regulate the rates of participants in the intensely competitive interexchange market would be arbitrary and capricious, and hence unlawful. *See Schurz Communications, Inc.* v. *FCC*, 982 F.2d 1043, 1053-54 (7th Cir. 1992) (citation omitted) (agency's inability to "justify about face" created when agency adopted regulatory approach having previously concluded that none of the market participants "had significant market power" and that the Commission should therefore "not intervene in the market except where there is evidence of a market failure" rendered its decision arbitrary and capricious); *Doyle* v. *Brock*, 821 F.2d 778, 786 (D.C. Cir. 1987) ("Where [an agency] pursues a course contrary to [its] prior practice, [it] is obliged to explain [its] actions more thoroughly than if [it] were following a consistent pattern").

In this regard, far from supporting regulation of the manner in which IXCs recover their fixed costs and USF contributions, as the Notice appears to imply (¶ 24), the Commission's Local Number Portability cost recovery order is yet further evidence of the Commission's longstanding policy of not regulating the manner in which competitive providers recover their costs from non-captive customers. In that Order, the Commission announced that it would "allow" -- but not require -- "rate-of-return and price-cap LECs to recover their carrier-specific costs directly related to providing long-term number portability through a federally tariffed, monthly number-

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[9] (...continued)
by the commission to reimpose rate regulation on nondominant IXCs would be hard to square with these deregulatory initiatives

portability charge that will apply to end users for no longer than five years."[10] That is, incumbent LECs -- dominant carriers whose prices are directly regulated -- could recover their LNP costs via end-user surcharges, but if they did so, they had to file tariffs complete with cost justifications. By contrast, the *LNP Cost Recovery Order* held that "other telecommunications carriers may recover their carrier-specific costs directly related to providing long-term number portability in any lawful manner."[11] In other words, the Commission refrained from regulating the manner in which IXCs and CLECs recover their LNP costs. As the Commission explained:

> Regulating the recovery of number portability costs by incumbent LECs, but not by competitive LECs, CMRS providers, and IXCs, also will not place any carrier at a competitive disadvantage. Creating an optional end-user charge for incumbent LECs ensures that such carriers have a reasonable opportunity to recover their costs and at the same time allows carriers to forego some or all of such charges if they deem it necessary to compete in the local service market. Similarly, unregulated carriers may recover their costs in end-user charges if they choose to do so. Regulating incumbent LEC recovery should not disadvantage incumbent LECs as compared to competitive LECs because competitive LECs also have number portability costs under LRN. If a customer does switch to a competitive LEC, that customer may have to pay end-user charges or service rates that recover the competitive LEC's portability costs. Thus, the customer's incentive to leave the incumbent LEC is offset by the fact that the customer would then have to pay charges that recover the competitive LEC's number portability costs. Therefore, incumbent LECs are unlikely to have a material disadvantage in competing for subscribers under our recovery mechanism.[12]

In short, the Commission's LNP Cost Recovery Order, consistent with the Commission's other precedents, actually undermines any suggestion that regulation of the manner in which non-dominant carriers recover their regulatorily-imposed or other costs could be appropriate.

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[10] Third Report and Order, *Telephone Number Portability*, 13 FCC Rcd. 11701, ¶ 9 (1998).

[11] *Id.*

[12] 13 FCC Rcd. 11701, ¶ 139.

A second, and equally central purpose of the 1996 Act was the elimination of the web of implicit subsidies that have historically characterized the telecommunications industry. Congress understood that such subsidies promote inefficient and competitively distortive behavior, and therefore mandated that any required subsidies be "explicit." 47 U.S.C. § 254(e). Indeed, the Fifth Circuit recently held that section 254(e) prohibits the Commission from requiring LECs to recover their universal service contributions though charges assessed on IXCs, rather than through explicit end user surcharges. *Texas Office of Pub. Util. Counsel et al.* v. *FCC*, 183 F.3d 393, (5th Cir. 1999). The Commission's Notice of Inquiry likewise acknowledges this Congressional policy, unequivocally stating that the Commission's Notice is not intended to "signal a change in [the Commission's] intention to phase in an economically rational common line rate structure, to eliminate per-minute common line charges, and to reduce the support burden on high-volume long-distance and business customers." NOI, ¶ 13.

Any Commission requirement that carriers "maintain rate plans that do not include a monthly charge," or "pass through a PICC calculated as a percentage of the bill, capped at a certain dollar level," however, would have precisely this irrational effect, and would thus be antithetical to the 1996 Act. As the Commission has often recognized, the elimination of implicit subsidies requires that non-traffic sensitive costs be removed from per-minute rates.[13] This ensures efficient, rational

[13] *See, e.g.*, First Report and Order, *In The Matter Of Access Charge Reform,* 12 FCC Rcd. 15982, ¶ 7 (1997) ("Because NTS [non-traffic sensitive] costs, by definition, do not vary with usage, the recovery of NTS costs on a usage basis pursuant to our current access charge rules amounts to an implicit subsidy from high-volume users of interstate toll services to low-volume users of interstate long-distance services."); *id.* ¶ 36 ("NTS costs incurred to serve a particular customer should be recovered through flat fees, while traffic-sensitive costs should be recovered through usage-based rates. The present structure violates this basic principle of cost causation by requiring incumbent LECs to recover many fixed costs through variable, per- minute access rates."); *id.* ¶ 69 ("Because (continued...)

pricing, and the lowest possible per-minute rates. The non-traffic sensitive costs that carriers incur when serving presubscribed customers, as well as the PICC charge (which is imposed by LECs on a per-line basis), are clearly non-traffic sensitive costs. Any requirement that IXCs eliminate such charges and recover these costs through per-minute rates instead would, therefore, mandate precisely the implicit subsidy of low-volume users by high-volume users that the Commission has acknowledged the 1996 Act was designed to eliminate. Rosston Decl. ¶¶ 53-56.

For this reason, although the Commission's Notice suggests that it "did not anticipate" that the imposition of flat rate charges on residential customers might require low-volume users to pay certain charges whereas "[p]reviously, such customers would have paid nothing to their presubscribed IXCs in a month in which they made no long-distance calls," NOI, ¶ 12, as the Commission elsewhere appears to acknowledge, it is simply unreasonable "to assume that implicit subsidies could be eliminated and competition introduced into previously regulated markets without some customers (those previously subsidized) paying more." *Id.*, ¶ 15. Prior to the emergence of competition, low-volume consumers of interLATA service were benefitting from implicit subsidies through higher per-minute rates on high-volume users. In a competitive market, carriers cannot continue to maintain per-minute rates above cost. Accordingly, carriers have no choice but to begin recovering non-traffic sensitive costs through flat-rated charges or minimum usage requirements imposed on end users.

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[13] (...continued)
common line and other NTS costs do not increase with each additional minute of use transmitted over the loop, the current per-minute CCL charge that recovers loop costs represents an economically inefficient cost- recovery mechanism and implicit subsidy.").

The imposition of flat-rated charges or minimum usage requirements on residential customers thus does not indicate that regulatory intervention is needed; it is a sign that the competitive and deregulatory processes the Commission has followed are working. Although certain low-volume users might see an increase in their monthly costs as a result of these flat fees, as pointed out above and as established more fully below, there is no reason to believe that the low-volume users who are subject to these charges are disproportionately low income and thus unable to afford them, or, to the extent that such users object to these charges, that they are incapable of taking advantage of the competitive market to avoid such flat fees.

In short, there is no justification for the Commission to regulate the prices charged by carriers in the vigorously competitive interexchange market. To the contrary, imposition of any such regulations would be antithetical to the terms and purposes of the 1996 Act, and would represent an arbitrary departure from long-standing Commission precedent.

II. LOW-VOLUME USERS AS A CLASS DO NOT REQUIRE SPECIAL REGULATORY PROTECTIONS.

In its Notice of Inquiry, the Commission seeks comment on whether it should impose various regulatory requirements targeted at prohibiting or restricting the imposition of flat fees on low-volume users. In particular, the Notice asks "whether the definition of 'affordability' under section 254 should allow a customer who ordinarily makes few long-distance calls to avoid minimum use charges," and "whether the concept of universal service should include some amount of affordable interstate interexchange service for low-volume users." NOI, ¶¶ 19b, 19c. Implicit in these questions appears to be the assumption that low-volume users are necessarily low income, and that such users therefore require the adoption of special regulatory protections. NOI, ¶ 19a (inquiring "whether a correlation exists between income and long-distance telephone usage"). The answer to the Commission's inquiry is clear: the evidence demonstrates that the low-volume users affected by AT&T's flat fees as a class are neither poor nor unaware of their myriad options in the competitive interexchange market.

First, although AT&T is not required to do so, AT&T waives each of the three items that are the focus of the NOI -- the monthly minimum usage requirement, the USF charge and the PICC pass-through charge -- for consumers who inform AT&T that they qualify for participation in the Lifeline program in their state.[14] See AT&T Tariff F.C.C. No. 27, §§ 3.5.12 (USF and PICC pass-through charges); 4.1.1.M.3, 4.1.1.N.3 (MUR). That waiver can be requested simply by calling AT&T's toll-free customer service number, and takes effect immediately (although customers must return documentation substantiating their qualification for the exemption to continue). Thus, low income consumers are not impacted by AT&T's minimum, USF and PICC pass-through charges.

Well before extending its Minimum Usage Requirement to existing customers, AT&T sent a number of direct mailings to lower-volume customers that might be affected by the requirement. In that mailing, AT&T clearly informed such customers of the Lifeline exemption, and how they could take advantage of it:

> Low-income customers can get help with the usage minimum. If you are enrolled in or eligible for a telephone support program such as Lifeline assistance, which helps customers pay for their local phone service, please call 1 800 293-9465. You will be enrolled in our enhanced AT&T Lifeline Program for your long distance service. AT&T will waive the usage minimum, as well as the 'Carrier line' and 'Universal connectivity' items, on your bill. When

[14] The NOI appears to suggest that AT&T does not waive the Minimum Usage Requirement for Lifeline customers. NOI, ¶ 23 n.29. That is not so, as demonstrated by the tariff provisions cited above.

you call, an AT&T representative will provide complete AT&T Lifeline enrollment information.[15]

AT&T's decision to waive these charges for Lifeline-qualified customers should fully address any legitimate concern that AT&T's flat-based charges implicate the definition of "affordability" under section 254, or require "corrective" regulatory action. It would clearly be unreasonable for the Commission to conclude that consumers who are deemed capable of affording to pay their full share of the costs of relatively essential basic local exchange services, which are used to reach emergency services and local health care providers, nevertheless cannot afford to pay their full share of the costs of interexchange service.

Second, as demonstrated more fully in the Rosston declaration, there is virtually no correlation between income and long-distance telephone usage. To the contrary, AT&T's data shows that across all income levels there is only a very slight difference in the average household incomes of high-volume users as compared with the low-volume users who would have paid some or all of the $3.00 minimum usage requirement had it been applicable to them at the time covered by AT&T's data (January, 1999).[16] In particular, the mean household income of all AT&T customers in January, 1999 was $44,738, while the mean household income of low-volume users who would have incurred the minimum charge was $43,160 -- a difference of just 3.5%. This minimal difference extends through all income quartiles. Thus, the mean household income of consumers in the 25th percentile of income was $31,176, as compared with an income of $30,263 for consumers subject to the minimum usage requirement -- a difference of 2.9%. Although the income differences between high

[15] See sample customer mailing, attached hereto as Exhibit B.

[16] During the time period covered by the data examined by AT&T's expert affiant, the minimum usage requirement only applied to customers presubscribing to AT&T after August, 1998.

and low-volume users may be "*statistically* significant" (*i.e.*, the results are sufficiently precise that they cannot be attributed merely to randomness in the sample), by any measure the difference is qualitatively negligible. Because high-volume and low-volume households have nearly identical incomes, AT&T's minimum usage requirement does not have a material impact on low-income users as a group. Rosston Decl., ¶ 27-28.

These data demonstrate that there is no meaningful relationship between income and long distance usage. Individuals with high income levels may consume little long distance service because their families may all reside locally, or because they use their telephone lines for Internet access via a local number, or for second homes that are only occasionally occupied. Individuals with lower income, by contrast, might be relatively high-volume users -- for example, if they are recent immigrants whose families live outside the United States. Thus, income level alone is a very poor indicator of long distance consumption.

Indeed, as these data demonstrate, the income characteristics of low- and high-volume consumers is very heterogenous. "Low-volume users include a large number of high-income households, and the overall group of AT&T customers includes a substantial number of low-income households that are not low-volume users." Rosston Decl., ¶ 29. For this reason, any regulation limiting the use of Minimum Usage Requirements (thus necessitating an increase in per-minute rates) "would in fact benefit high-income subscribers with low long-distance volume at the expense of low-income subscribers who make more than a minimal amount of long-distance calls." Rosston Decl., ¶ 31. Such regulation thus could not be justified as an attempt to assist low-income customers.

Third, AT&T's data demonstrate the existence of significant levels of churn even among low-volume users. In particular, AT&T's data reveal that in 1998 customers with average monthly bills below $10 switched long-distance service providers more often than customers with bills between $10 and $25. The existence of this level of churn shows that low-volume users are fully capable of protecting their interests in a competitive market by switching carriers, and is fully consistent with the Commission's long-standing finding that residential consumers have highly elastic demand curves. *See*, In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended, *Second Report and Order*, 11 FCC Rcd 20730 (1996). ¶ 21 ("We conclude, consistent with the AT&T Reclassification Order, that the high churn rate among consumers of interstate, domestic, interexcahnge services indicates that consumers find the services provided by interexchange carriers to be close substitutes, and that consumers are likely to switch carriers in order to obtain lower prices or more favorable terms and conditions." (citations omitted)

In short, there is no basis for concluding that low-volume users of long distance service as a class require special regulatory protections. These consumers exhibit virtually the same income characteristics of higher volume users, and have demonstrated an ability and willingness to change long distance carriers when they deem it desirable. The income and other characteristics of low-volume users thus provide no justification for the Commission to depart from its long standing refusal to regulate the prices charged by interexchange carriers.

III. AT&T'S MINIMUM USAGE, USF AND PICC PASS-THROUGH CHARGES ARE REASONABLE EFFORTS BY AT&T TO RECOVER ITS COSTS, AND SHOULD NOT BE PROHIBITED OR RESTRICTED.

In the exercise of its best business judgment as a carrier in a vigorously competitive market, AT&T has chosen to impose three billing items on residential interexchange customers: a monthly minimum usage requirement of $3.00, a monthly USF contribution charge of $0.99, and a monthly PICC pass-through charge of $1.51. Each of these items is a reasonable attempt by AT&T to recover its actual costs, and there is no reason for the Commission to regulate either the level or structure of these charges.

The Minimum Monthly Usage Requirement ("MUR"). IXCs, including AT&T, incur two types of costs in providing service to presubscribed customers. Fixed (non-traffic sensitive) costs, and variable costs (traffic-sensitive). AT&T's fixed costs include a number of different components. The costs of billing customers and of maintaining customer account and billing systems is a significant cost incurred by AT&T that varies with the number of presubscribed customers, but varies little with usage. Although AT&T can reduce some of its billing costs by billing on a bimonthly or quarterly basis, AT&T has estimated that its billing and other fixed costs exceed $3.00 per customer, per month even when billing is done on a less frequent than monthly basis.[17] Other non-traffic sensitive costs incurred by AT&T are the costs of customer contacts (*e.g.*, direct mailings), marketing, maintenance of round-the-clock customer service via a toll-free number, and, of course, the maintenance of sufficient network capacity to ensure that when presubscribed customers do call, their calls go through. Rosston Decl., ¶ 53-54.

Precisely because these costs (which in fact exceed $3.00 a month) are not traffic-sensitive, AT&T incurs these costs even when a customer does not make any calls. Because customers with low call volume otherwise would not pay enough through per-minute rates to enable AT&T to recover its fixed costs, in the absence of a minimum usage requirement AT&T would either be unable to recover its costs (an unsustainable position in a competitive market), or would have to

[17] Indeed, some costs, such as uncollectibles, *increase* with the use of bimonthly or quarterly billing. Moreover, in those many instances when AT&T does not perform billing functions itself, bimonthly and quarterly billing requires the cooperation of a customer's LEC.

increase its per minute rates (a course of action that, because AT&T has a disproportionate number of the industry's low-volume users, would place AT&T at a distinct competitive disadvantage vis a vis its competitors). Most important, as discussed above, any requirement that AT&T recover its costs exclusively through per-minute rates would require maintenance of the very type of implicit subsidy that the 1996 Act was designed to eliminate. *See supra* __. Rosston Dec. ¶¶ 59-64.

To address this problem of under-recovery, AT&T, in the exercise of its business judgment, decided to begin imposing a minimum usage requirement of $3.00. This is not a plan fee, but a usage requirement. Thus, even AT&T One Rate® customers need place only 20 minutes of calls per month to avoid incurring the MUR altogether.[18] Moreover, there are numerous ways in which AT&T customers can satisfy this minimum. Domestic interLATA, international, intraLATA toll, calling card, operator-handled and directory assistance calls all count towards the minimum, as do AT&T Wireless calls when billed in combination with AT&T long distance.[19] Customers with more than one line can also combine their lines onto one bill, in which case their combined lines will be subject to only one minimum. Customers enrolled in AT&T One Rate OnLine® also do not incur the minimum usage requirement, because those customers arrange to have their credit cards or checking accounts directly debited, and this arrangement (in conjunction with the elimination of a paper bill) substantially reduces AT&T's billing and collection costs.[20] Such customers are also less

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[18] AT&T's basic One Rate® Plan offers callers state-to-state calling for 15 cents a minute, 24 hours a day, seven days a week, with no plan fee (but subject to the $3.00 usage minimum).

[19] In those areas where AT&T cannot bundle wireless and wireline long distance billing, AT&T will waive the MUR upon request.

[20] Customers with low long distance usage due to the fact that they use their line primarily for Internet access may find this option especially attractive.

costly to serve because they can meet a greater percentage of their customer service needs using online resources. Finally, AT&T does not impose the Minimum Usage Requirement in non-equal access areas where customers do not have the option of presubscribing to other IXCs.[21] Accordingly, the only customers that are subject to AT&T's Minimum Usage Requirement are customers who have preferred to remain presubscribed to AT&T, rather than presubscribe to any of the multiple alternative carriers available to them who do not impose a usage minimum.

In the direct mailings that AT&T used to inform Basic Schedule customers of the MUR, AT&T not only informed customers clearly of the existence of the MUR and of its potential impact on their long distance bills, but also introduced a new calling plan -- AT&T Monthly Minutes℠ 30 for $3 -- that targets the needs of low-volume users. That plan provides customers with 30 minutes of long distance for $3.00 (*i.e.*, at a rate of 10 cents per minute, and charges 20 cents per minute for state-to-state calls thereafter. This plan permits even low-volume users to obtain the benefit of one of the lowest rates available in the market with no surcharge, thus demonstrating that low-volume users are clearly benefitting from the existence of a competitive and de-regulated interexchange market. AT&T advised its customers that this plan "may be the option for you" if they made roughly 30 minutes of calls a month. AT&T's mailing provided an easy-to-use postcard with a box that customers could use to change to that plan, or to subscribe to AT&T's One Rate plan (15 cents per minute, no monthly fee, $3.00 MUR). AT&T's mailing also provided customers a toll-free

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[21] AT&T likewise does not impose the MUR on AT&T One Rate® customers who enrolled in that calling plan prior to the introduction of the MUR on August 15, 1998, and who have remained enrolled in that plan since that date at the same residence. AT&T decided to grandfather these customers on the basis of AT&T's determination that these customers had a reasonable expectation at the time they enrolled in AT&T One Rate® that they would not be subject to any MURs or plan fees.

number they could call to subscribe to those plans. Because the MUR was introduced in tandem with a reduced per-minute plan targeted at low-volume users, low-volume customers who were previously on AT&T's Basic Schedule and who enrolled in the Monthly Minutes℠30 for $3 plan saw a *reduction* in their total long distance charges with as little as *twelve minutes* of monthly usage.[22]

There is nothing unusual about the decision by some IXCs to assess minimum usage requirements on customers. Providers of numerous other services, both in the communications industry and elsewhere, routinely recover their fixed costs by imposing minimum usage or flat rate charges that apply regardless of usage. *See* NOI, ¶ 26. For example, AT&T has surveyed the prices charged by the BOCs for local exchange service in every state. No BOC offers a purely usage-rated plan, and the minimum charges the BOCs impose regardless of usage vary by state from $5 to $10 dollars per month. Wireless service providers uniformly charge a flat or minimum usage charge that requires customers to incur a fee even in months that they make no calls.[23] Other public utilities, such as gas, electric, and cable companies similarly charge minimum usage and flat fees. *See* Rosston Decl. ¶ 77 & Exhibit 2. In short, customers are accustomed to incurring minimum usage and flat fees for the benefits of obtaining access to common carrier and public utility networks. Low-volume users can scarcely complain that the subsidy they have received from IXCs (who nearly alone among such service providers have heretofore not imposed such charges) is ending as telecommunications markets can no longer sustain such subsidies.

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[22] The peak rate under AT&T's Basic Schedule is 26 cents per minute.

[23] Some wireless providers require customers instead to purchase a block of minutes, either monthly or on some other periodic basis. Because those minutes expire if not used within a certain time frame, these plans effectively operate in the same manner as minimum usage requirements.

For these reasons, AT&T firmly believes that the minimum usage requirement it imposes is a reasonable method of recovering the non-traffic sensitive costs that AT&T incurs in providing presubscribed customers with the benefits they receive from access to AT&T's network and services. If AT&T is mistaken in this view, however, market forces alone will address consumers' concerns and satisfy consumers' needs. Low-volume users who believe that they are adversely affected by the MUR have many alternatives available to them. IXCs have employed varying strategies for attracting customers, and there are many IXCs that offer rate plans for presubscribed customers that do not impose a minimum usage requirement. Customers can also choose to de-PIC and instead use either the services of the numerous dial-around carriers who heavily advertise the fact that they do not impose monthly fees, or prepaid or calling cards. Given the ease with which customers that wish to avoid minimum usage requirements for interexchange service can do so, there is clearly no need for regulatory intervention. Rosston Decl. ¶¶ 39-45.

At the same time, although it is true that many IXCs have offered plans without minimum usage requirements, all IXCs incur non-traffic sensitive costs that they have to recover in some manner. IXCs that do not impose explicit MURs simply recover their fixed costs from low-volume users in other ways. For example, as discussed more fully in the Rosston declaration, both SNET and GTE offer interexchange service on a sliding scale, with higher per minute charges for lower volume users. Those carriers thus simply use a less explicit method of ensuring that low-volume users pay a share of the fixed costs they impose. Rosston Decl. ¶ 64.

This does not mean, however, that high-volume users are being subsidized by low-volume users. Most discount rate plans in the industry, for example, include monthly fees that, unlike a minimum usage fee, customers must pay in addition to any usage fees they incur. Indeed, under

AT&T's pricing plans, assuming rational behavior by consumers, high-volume users actually would make a greater contribution towards non-traffic sensitive costs than low-volume users. For example, as explained more fully in the Rosston declaration, a high-volume subscriber to AT&T's 7 cents per minute plan that does not presubscribe to AT&T for intraLATA toll will make a $5.95 contribution to AT&T's recovery of fixed costs, even if one assumes that the 7 cents per minute rate recovers only AT&T's traffic sensitive costs and no more. By contrast, at all usage levels a low-volume user enrolled in AT&T One Rate® (15 cents a minute) would contribute less than $5.95 -- usually far less. Specifically, under the assumptions above, a low-volume user with no usage would contribute $3.00, while a user with 20 minutes of usage would contribute only $1.60 towards fixed costs.[24] As the Rosston declaration explains, under any set of assumptions concerning AT&T's traffic-sensitive costs, low-volume users are not being asked to subsidize high-volume users. Rosston Decl., ¶¶ 55-56.

The Universal Service Charge. AT&T's use of a flat rate fee to recover its contributions to the universal service fund from residential customers is likewise clearly reasonable. It is beyond dispute that AT&T incurs costs in contributing to the universal service fund, and that AT&T may legitimately recover those costs through express line-item charges. Indeed, the Fifth Circuit recently held that it would be unlawful for the Commission to require carriers to recover their USF charges implicitly, rather than explicitly. *Texas Off. of Pub. Util. Counsel et al.* v. *FCC*, 183 F.3d 393, 1999 U.S. App. LEXIS 17941, *63 (5th Cir. 1999). The only potential point of dispute with respect to AT&T's USF charge, therefore, would be AT&T's decision to recover its

[24] That is, 20 minutes at 8 cents per minute. 8 cents represents the per minute amount above the 7 cent variable cost rate that is paid by low-volume users under the One Rate plan. While the contribution amount would exceed $5.95 at 75 minutes of usage, at that level of usage a rational consumer would enroll in the 7 cents per minute plan instead.

contributions from residential customers on a flat-rate, rather than percentage basis. For the reasons established below, there is no basis for the Commission to restrict the pricing flexibility nondominant interexchange carriers utilize in their efforts best to satisfy consumer preferences.

AT&T chose to recover its USF contributions on a flat rate basis only after extensively surveying its residential consumers, and determining that a majority of them consistently preferred the certainty and predictability of a flat rate charge to a percentage charge. Specifically, AT&T hired an outside expert to survey AT&T customers as to their preferences between various methods that AT&T might use to recover its USF contributions. Significantly, across each usage, age and income level, customers preferred a purely flat charge. Rosston Decl., ¶¶ 67-68.

On this basis, AT&T concluded that use of a flat-rate USF charge would best satisfy the preferences of the majority of consumers, including low-volume users. If AT&T is correct in that judgment, it will be rewarded by retaining most of its existing customers and by attracting new customers who do not like percentage charges. Conversely, low-volume consumers who prefer a percentage based fee can choose to presubscribe to each of the numerous other IXCs who have chosen to recover their USF charges on a percentage basis. By any measure, however, such rate design questions are at the heart of competition in the long distance market, as carriers seek to differentiate their offerings. The worst possible outcome would be for the Commission to prescribe a single rate structure for all IXCs and thus defeat this process.

The Flat Rate PICC Pass-Through Charge. Like other major IXCs, AT&T assesses a flat PICC pass-through charge that is designed to recover the primary and secondary line PICCs that LECs charge to interexchange carriers pursuant to the Commission's rules. In AT&T's case, this amount is set at $1.51 per account. As with the USF fee, it is beyond dispute that LECs assess AT&T primary and secondary PICC charges for each line presubscribed to AT&T, and in a competitive market, AT&T has no choice but to recover these costs from its presubscribed customers. Indeed, the Commission's access charge orders clearly anticipate that IXCs would pass on PICC charges to their customers. Second Order on Reconsideration and Memorandum Opinion and Order, *Access Charge Reform*, 12 FCC Rcd. 16606, ¶¶ 16-18 (1997). The only possible complaint, therefore, regarding AT&T's assessment of an explicit line-item PICC pass-through is that AT&T, like each of the major IXCs, decided to use an "averaged PICC pass-through charge" (NOI, ¶ 14) rather than passing through the primary line PICC charge to primary line subscribers and the secondary line PICC charge to secondary line subscribers. AT&T's decision to use a blended PICC rate is a reasonable effort by AT&T to recover costs in an efficient and not overly-burdensome manner.

As the Commission is aware, at the time that AT&T decided to impose a blended PICC pass-through charge the LECs were not providing AT&T with billing records that enabled AT&T to determine which of its customers have primary lines and which have non-primary lines. NOI, ¶ 14. Although the Commission has since taken regulatory action to correct this problem, *id.*, AT&T had no alternative when initially designing its billing systems to implement the PICC pass-through charge, than to do so on a blended basis.

Any requirement that AT&T now modify the manner in which it passes through PICC charges would be both unnecessary and unwarranted. To begin with, imposition of such a requirement would indisputably impose significant costs on AT&T and other IXCs, costs that in turn will have to be recovered from consumers. In particular, to alter its billing methods now AT&T would not only have to undertake modifications to its billing system software, but would have to undertake a time-consuming and costly effort to reeducate consumers about the change in the charges imposed on them.

AT&T might have undertaken these costly efforts on its own initiative if the PICC pass-through problem were significant in impact or of long duration. One RBOC (Pacific Bell) is expected imminently to phase out the differential between primary and secondary line PICCs, and the other major price cap LECs will eliminate theirs relatively soon thereafter. The issue of blending PICC pass through charges would thus become moot with respect to many customers almost as soon as (or even before) the necessary modifications to billing systems could be implemented.[25] Indeed, because the time frame within which the LECs are phasing out the differential between primary and secondary line PICCs varies from LEC to LEC, if AT&T were prohibited from using a blended pass-through rate AT&T would be required to vary its charges by LEC region -- a burdensome task for a nationwide carrier such as AT&T.

Moreover, the use of an averaged PICC pass-through rate has only a minimal impact on consumers. The current primary line PICC ceiling is $1.04 per month. NOI, ¶ 9. By contrast, AT&T assesses a PICC charge of $1.51 per month. The impact on a single-line customer of AT&T's blended PICC rate is thus roughly 47 cents a month. Given the costs that AT&T would incur to modify its billing systems, any net savings to consumers resulting from a change in the manner in which AT&T passed through PICC charges would likely be negligible.

Finally, a single-line customer that is sufficiently troubled by AT&T's $1.51 assessment has two competitive alternatives. First, that customer could presubscribe to an IXC that

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[25] AT&T's billing systems are large and complex systems that interact with other, equally complex systems. Modifying these systems is therefore an expensive and time-consuming process.

does not use a blended rate, or that imposes a lower averaged fee. Second, that customer could choose to de-PIC, and pay his or her LEC directly the precise primary line PICC charge assessed by that LEC.[26]

In light of these competitive alternatives and the minimal nature of the impact on customers, the Commission should not depart from its longstanding policy against regulating nondominant IXCs by regulating the manner in which those carriers recover PICC costs.

IV. THE COMMISSION SHOULD NOT REWARD THE BOCS FOR THEIR FAILURE TO OPEN THEIR LOCAL MARKETS BY GRANTING THEM PREMATURE INTERLATA RELIEF.

In its Notice, the Commission seeks comment on whether, in light of the fact that LECs already incur billing and other fixed costs in providing local service, and the supposition that they "would presumably experience little incremental costs if they became the customers' presubscribed IXCs as well," the "entry of [BOCs] into the long-distance market will mitigate the problems currently experienced by low-volume long-distance users." NOI, ¶ 17. This proposition is both remarkable and wrong.

As an initial matter, the Commission's inquiry proceeds from the false premise that there are "problems currently experienced by low-volume long-distance users." As shown above, however, low-volume users benefit from a vigorously competitive interexchange market, and have many alternative offerings from which to choose to satisfy their long-distance needs at reasonable prices.

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[26] In that regard, the Commission could certainly take steps directly to inform customers that they have the right not to presubscribe to any IXC and may instead choose to utilize exclusively the services of a dial-around carrier. *See* NOI, ¶ 21(d). The Commission should not, however, mandate that IXCs, either through bill inserts or otherwise, be required to explain the de-PICing option to consumers. Rosston Decl. ¶¶ 83-85.

Moreover, the fact that the BOCs today are the only entities that would be capable of providing a bundled "one-stop" offering of local and long distance service to residential customers on a widespread basis is precisely why the BOCs must not, and may not lawfully, be granted § 271 authority. AT&T does not dispute that the offering of bundled services can often yield efficiencies, and that a provider of a bundle of local exchange and long distance service could avoid the need to impose additional charges to the flat fees it collects from its local exchange customers in order to recover many of the billing and account-related costs of providing interexchange service. Indeed, that is why AT&T itself waives its minimum usage requirement entirely for customers that receive their local service from AT&T. AT&T Tariff F.C.C. No. 27, § 4.1.1.M.3.b. Today, however, AT&T and the other IXCs cannot provide residential customers with a widespread bundled offering of local and long distance service for one reason: because the BOCs continue to maintain a monopoly stranglehold over their local exchanges, and have consistently failed to satisfy the 1996 Act's market opening requirements. Accordingly, three and one-half years after passage of the Act, not a single BOC has satisfied the section 271 competitive checklist or other statutory requirements that the BOCs must meet before they may lawfully be permitted to provide in-region interexchange service. Because the BOCs thus retain a monopoly power in the local exchange market that they could leverage into the interexchange market, granting BOCs premature interLATA relief would not lead to decreased long distance pricing, but rather to restricted output and higher prices.

The remedy for this problem is for the Commission to continue to press the BOCs to comply with their section 251 and 252 obligations, and to continue to deny the BOCs' requests for interLATA authority until they have fully satisfied the section 271 competitive checklist and public interest standards. The Commission should not -- and lawfully may not -- reward the BOCs for their failure to open up their local markets by granting them premature section 271 relief.

Indeed, a decision by the Commission to grant the BOCs in-region interLATA authority on the ground that they, but not IXCs, are able to provide a bundled one-stop residential offering would stand the 1996 Act on its head. As the Commission held in its *Qwest* order, one of the fundamental purposes of section 271 was to prohibit the BOCs from providing a bundled one-stop offering before the BOCs had taken all of the necessary steps to enable IXCs to provide their own similar bundle, and thereby to preserve the BOCs' incentives to open their local markets to competition.[27] Any decision to permit the BOCs' to enter the long distance market at a time when only they could provide a widespread residential one-stop offering would thwart Congressional intent and would be patently unlawful.

A comparison of the state of competition in the interexchange and local exchange services markets vividly confirms these principles. As demonstrated above, consumers of long distance service have seen sharp reductions in their rates. Indeed, in the last two years alone AT&T's

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[27] Memorandum Opinion and Order, *In The Matter Of AT&T Corp. v. Qwest Communications Corp.*, 13 FCC Rcd. 21438, ¶ 5 (1998) ("Congress recognized that, unless the BOCs had some affirmative incentive to open their local markets to competition, it would be highly unlikely that competition would develop expeditiously in the local exchange and exchange access markets. Accordingly, section 271(a) allows a BOC to enter the in-region, interLATA market, and thereby offer a comprehensive package of telecommunications services (i.e., one-stop shopping for local and long distance service), only after it demonstrates, among other things, compliance with the interconnection, unbundling, and resale obligations that are designed to facilitate competition in the local market."); *id.* ¶ 7 ("Under this statutory framework, carriers will achieve significant competitive advantages when they can provide customers with combined packages of local and long distance services. These advantages are key to understanding the competitive harm that could result from premature BOC entry into the long distance market. Premature entry would reduce the BOCs' incentives to open their local markets, which was one of the major goals that Congress sought to achieve in the 1996 Act.") (citation omitted).

lowest One Rate plan rate has decreased in price from 15 cents a minute to 7 cents a minute. By contrast, during the same time period, the price of local exchange service has remained unchanged, or has even increased. The reason for the difference is clear: the interexchange market is vigorously competitive, whereas the local exchange market, especially for residential consumers, remains monopolistic. Far from supporting the conclusion that the BOCs should be granted interLATA relief, granting the BOCs premature interLATA entry would only threaten to bring the BOCs' monopoly pricing model to the long distance market.

V. EXCEPT FOR REQUIRING LECS TO RECOVER PICC CHARGES AND USF CONTRIBUTIONS FROM THEIR END USERS DIRECTLY, THE COMMISSION SHOULD NOT PURSUE THE NOI's REMAINING REGULATORY PROPOSALS.

1. The LECs Should Be Required to Assess PICC and USF Charges Directly on Their End Users.

In its Notice, the Commission inquires whether it "should [] require LECs to bill the residential PICC directly to the end user, rather than bill it to the IXC." NOI, ¶ 18. AT&T supported such action in the recent coalition filing on access reform,[28] and believes that the Commission should adopt it.

The PICC charge, like the subscriber line charge, is designed to recover the interstate-assigned non-traffic sensitive costs of the common line. Consistent with principles of cost-causation, the PICC charge should therefore be assessed by the LECs directly on end users. Rosston Decl. ¶ 57. Recovery of the PICC charge from end users by their LEC is also most efficient, because it would create only one set of billing and collection costs. Rather than requiring LECs to assess the PICC on

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[28] *See* Universal Service and Access Reform Proposal, § 2 (Letter from James W. Cicconi, AT&T Corp., et al. to Chairman William E. Kennard, Federal Communications Commission, July 29, 1999).

IXCs, with IXCs then incurring additional costs to recover the PICC from end users, LECs should simply bill the charge to their end users directly. As the NOI recognizes, to the extent the Commission is concerned that single-line customers not pay a blended PICC pass-through charge, requiring LECs to assess the charge on end users directly would "help ensure that single-line customers do not pay an averaged residential PICC." NOI, ¶ 18.

The Commission also inquires whether it should "stop allowing LECs to recover their universal service contributions from IXCs through the so-called 'flow back' mechanism." As the Court of Appeals for the Fifth Circuit recently held, the Commission may not require LECs to recover USF contributions implicitly through access charges. *Texas Off. of Pub. Util. Counsel et al.* v. *FCC*, 183 F.3d 393, 1999 U.S. App. LEXIS 17941, *63 (5th Cir. 1999). Instead, the Fifth Circuit concluded that all such recovery must be explicit to the customer, and that LECs must recover those charges from their end users. The Fifth Circuit's invalidation of the flow-back mechanism thus moots this issue.

2. There is No Lawful Basis for the Commission Selectively to Impose <u>Regulations on Particular IXCs.</u>

The Commission's NOI further inquires whether the Commission should impose various regulations on "all or some subset of IXCs." NOI, ¶ 21. AT&T demonstrated above that it is both unnecessary and harmful for the Commission to regulate the manner in which nondominant IXCs recover their costs. *See supra* pp. 7-20. It would be particularly arbitrary and unlawful, however, for the Commission selectively to impose additional regulatory burdens on "some subset of IXCs" that would not apply to others.

As established above, *supra* pp. 7-10, the Commission has long recognized that no IXC, including AT&T, possesses market power in the interexchange market, and that there exists an "intense rivalry" among competitors in that market. For this reason, there is no legitimate basis whatsoever on which the Commission could choose to impose regulatory burdens on one IXC, or class of IXCs, that would not apply to others. Adoption of such a course would profoundly distort competition in the interexchange market by artificially giving a cost advantage to those carriers who would not be subject to regulation.

Indeed, it would be clearly arbitrary for the Commission selectively to impose regulations on only some of many competing firms in the market. As the Court of Appeals for the District of Columbia Circuit has squarely held, "equalizing competition among *competitors*" is "*not* the objective or role assigned by law to the Federal Communications Commission." *Hawaiian Tel. Co.* v. *FCC*, 498 F.2d 771, 776 (D.C. Cir. 1974) (emphasis in original). Selective imposition of regulatory burdens, however, could only have one purpose: the unlawful attempt to favor one class of carriers over another.

3. The Commission Need Not, and Should Not, Regulate the Manner in Which IXCs Pass Through Access Charge Reductions to Consumers.

The NOI seeks comment on whether, "consistent with the continued treatment of IXCs as non-dominant carriers, the Commission should require [IXCs] . . . to pass through a specific portion of interstate switched access charge reductions to a basic rate plan." NOI, ¶ 21. The Commission should unequivocally reject this suggestion. Because nondominant carriers cannot successfully maintain prices above cost, market forces alone are sufficient to ensure that access charge reductions will be passed on to consumers. That is why the Commission has consistently held that it need not attempt to regulate the manner in which IXCs pass reduced costs on to their customers. *See, e.g.*, Fourth Report and Order, *Price Cap Review for Local Exchange Carriers; Access Charge Reform*, 12 FCC Rcd. 16642, ¶ 185 (1997) (rejecting proposal that IXCs be required "to flow through to [] end users the reductions in the access charges they pay" on the ground that "there are no longer any dominant carriers in the market for interexchange services, [] long-distance carriers have been passing through access charge reductions in the past, [and there is] nothing to indicate that market forces will not compel IXCs to flow through access charge reductions"); Report to Congress, Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579, 13 FCC Rcd. 11810, ¶ 28 (1998) ("Because past experience indicates that long distance carriers tend to compete on the basis of per-minute rates . . . this competition creates strong incentives for carriers to reflect reductions in their costs through lower rates. Therefore, we would expect long distance companies to pass through access charge reductions" without regulatory intervention).

These principles apply to all customers, including customers paying AT&T's "basic" rates. As demonstrated above, low-volume users are a heterogenous group that reflects the income characteristics of all AT&T customers, and numerous "dial-around" and other carriers heavily advertise plans that target these groups. *See supra*. If a carrier were to price "Basic" rate plans above cost, other carriers would simply under-cut the carrier's prices and win precious market share. Indeed, in response to these competitive pressures, AT&T itself has recently offered a discount calling plan that offers low-volume users attractive savings over AT&T's Basic Schedule rates. There is thus no reason to believe that market forces are any less effective in ensuring that low-volume users receive the benefits of access charge reductions than they have been in providing savings to high-volume customers.

4. There Is No Basis For the Commission's Paternalistic Suggestion That Customers Are Unable Rationally To Select Suitable Price Plans.

Finally, the Commission inquires whether, if IXCs offer flat-rated calling plans, "the Commission [should] intervene if a customer chooses such a plan, and the Commission later determines that a usage rate plan would result in a nominally lower bill for the consumer." NOI, ¶ 26. Any such requirement -- akin to requiring a liability insurer to refund the premiums paid by an insured if, at the end of the policy period, the customer had no claims -- would not only be paternalistic, but would substantially distort the marketplace.

The Commission's repeated conclusion that it need not regulate IXCs' pricing because customer demand is highly elastic necessarily depends on the sensible finding that customers have the capacity to act in an economically rational manner and select plans that they could reasonably expect to be least costly to them. There could be no way for the Commission to square a policy of one-sided after the fact intervention into the agreements between customers and carriers with those longstanding findings.

Moreover, any one-sided attempt to "protect" consumers from their own choices would by highly unfair. If IXCs were to offer a flat-rated residential calling plan, that plan would be priced based on assumptions of average consumer usage. It goes without saying that if individual consumers, or consumers as a whole, have higher than expected usage (or usage that is more heavily weighted to peak periods than expected), the carrier will lose money on such consumers. Clearly, therefore, both carriers and consumers take a certain risk with flat rate calling plans, and it would be highly inequitable and arbitrary for the Commission to permit consumers, but not carriers, to avoid the consequences of the risk that they accepted in either offering or enrolling in a calling plan.

CONCLUSION

For the reasons set forth above and in the attached Declaration of Gregory L. Rosston, the Commission should not regulate the prices charged by participants in the vigorously competitive interexchange market.

Respectfully submitted,

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